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ABSTRACT

Budgeting by the states to improve quality in higher education is discussed. Among the quality issues, the following are important in a number of states: a need for stronger programs in engineering, computer science, and technology fields; a need for better preparation of public school teachers; and concern with lowered admissions standards and too much remedial work. It is claimed that if budget reform is to be successful in the future, it has to proceed from some organizational theory that fits colleges and universities, and from a concept of the governance relationship between states and institutions. Four models of state-institutional relationship are presented that vary along a continuum from control to autonomy (i.e., state agency, state-controlled institution, state-aided institution, and corporate or free-market). Concepts of university action are discussed, including the following: universities do goal directed planning, and they are influenced by market and other external forces. Dimensions such as centralized/decentralized budget decisions and accountability are also addressed to help understand the likelihood of successful budget reform. Finally, six characteristics of state budget systems that will encourage change and improvement are identified. (SW)

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HOW CAN STATES BUDGET FOR QUALITY

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HOW CAN STATES BUDGET FOR QUALITY

The budget is one of the primary means for the state to implement its policy objectives in higher education. Through its resource allocation decisions, the state can shape the direction of higher education and can implement some priorities and defer others. State budget policies differ substantially among the states; as do the systems of public and independent institutions. Different state budget policies and procedures are partly the result of history, partly the result of differing objectives, and partly the result of different conceptions of the relationship between the state and its institutions.

Higher education institutions are operating in a rapidly changing environment, with variable enrollment prospects, changing student demand for programs, and changing public expectations about what higher education should do. The economy and the fiscal prospects for higher education are also variable, with limited funds and inflation making it increasingly difficult for institutions to remain dynamic and innovative.

The economic and other problems have caused a number of states to look for new budget procedures and policies that will enable the state to achieve its higher education objectives and will enable institutions to operate effectively in the environment of the 1980's and 1990's.

State fiscal procedures and policies were developed during a period of growth and institutional expansion. Access was a primary objective, as was the preparation of professionals and managers for a complex and

increasingly technological society. Equity in the treatment of institutions was an important political objective. As funds increased spending controls also increased in a majority of states.

In the last decade, the emphasis has shifted to better management of institutions and systems and a variety of specific quality concerns.

Among the quality issue, the following are important in a number of states:

- a) A need for stronger programs in engineering, computer science and other fields that will make the state a more attractive environment for high technology industry.
- b) A need for better preparation for public school teachers, including higher standards for admission to teaching, and more subject matter courses.
- c) Concern for lowered admissions standards and too much remedial work. There is action in most of the states to raise requirements for entry to higher education, or at least to some of the public universities. Competency test requirements and high school subject requirements for graduation are being raised.
- d) A belief that colleges should sharpen up their mission, evaluate their programs more rigorously, and shift resources from low to high priority programs.
- e) Concern that fund shortages have made it difficult for institutions to develop new programs or upgrade old ones or develop the necessary innovations to serve clientele better. Institutions need access to developmental funds as much or more during the present time as they did during the growth

period.

- f) Concern that the failure of faculty salaries to keep up with the cost of living (faculty salaries on the average have lost about 20% of their purchasing power in the last decade)¹ has damaged faculty morale, and reduced the quality of effort that faculty bring to their jobs. There is only self-reported evidence about the amount of effort and time that faculty give to their jobs, and no hard evidence on the quality of efforts.

In most states, institutions have been responsible for quality maintenance; the state provided funds and some broad determination of roles and missions but left standards, teaching methods, and student selection entirely to the colleges. Accreditation was the most widely used process for quality assurance, and it was controlled by the institutions and had limited credibility with state officials and legislators. Most state budget systems have reinforced the state-institutional division of responsibility by not attempting to fund quality factors in the institutions.

While budget systems might not include specific qualitative assessment in resource decisions, it is clear that the way funds are allocated does affect the quality of institutional operations in important ways. If the state leaves the allocation of funds to the institution, the institution's decisions can have a major effect on the possibility of achieving some state objectives. Therefore there is an ongoing tension between state and institutional objectives, and the conflict will increase when funds are short and difficult choices have to be made.

Budget reform will not achieve its objectives unless the revised policies and procedures are consistent with the organizational

assumptions that are being made about the state-institutional relationship, and the assumptions about the way that decisions are made within institutions.

The history of budget reforms like PPBS and Zero Based Budgeting illustrates the need for congruence between budget systems and organizational and operational realities. The rise and fall of PPBS in the federal government was followed by a similar pattern in a number of states.² The planning, programming budgeting systems assume that the organization has clear goals, agreed upon processes and technology for achieving the goals, and ways of assessing progress (or lack of it). The actual budget process followed in most states is a combination of political bargaining among interest groups in which qualitative factors institutional goals are seldom explicit. The PPB and ZBB budget reforms didn't fit the realities of state-institutional decision making, and were soon abandoned.

If budget reform is to be successful in the future, it has to proceed from some organizational theory that fits colleges and universities, and from a concept of the governance relationship between states and institutions.

State Institutional Governance Relations

Four different models along a continuum from control to autonomy can be identified. At one end of the continuum is the view that public universities are primarily state agencies like any other part of state government. Second is the view that universities are "modified" government agencies with a claim to less state control because of the professional nature of their work and the need for academic freedom in teaching and research. Third is a governance arrangement that

universities are state aided, state regulated corporations, semi-autonomous in operations. At the other end of the continuum are autonomous institutions, that are organized as independent corporate bodies (private institutions have this status now). The institutions may contract with the state to provide certain services. Table I outlines the financing, budgeting and accountability that is most consistent with these different state-institutional relationships.

This framework for looking at state institutional budget relationships was originally developed by the state of Washington Council on Postsecondary Education.³ Most states have relationships with their public institutions that are somewhere between the second and third models. Relationships with the private sector correspond to the fourth model in most states. The Washington Council recommended that the state should develop a policy " . . . directed toward increased institutional fiscal flexibility . . . greater responsibility should be vested in governing boards and institutional officials as the primary means to local revenue generation and cost efficiency."⁴ The Council recommended moving the state institutional relationship toward the "state related" model in the state of Washington.

During the expansion of the 1960's and 1970's, state funds to higher education increased greatly, and there was an increase in budget controls that accompanied the additional funds in a majority of states. State institutional relations moved in incremental steps toward the "state controlled" model. When state support leveled off and began to decline in constant dollar terms in a majority of states in the last five years, institutions began to seek more budget flexibility and fewer rules. The exchange theory of organizational relationships is that institutions are willing to give up control in return for more

FOUR MODELS OF STATE-INSTITUTIONAL RELATIONSHIP

TABLE I

Characterization	State Agency (1)	State-Controlled Institution (2)	State-Aided Institution (3)	Corporate or "Free-Market" Model (4)
Financing	1. All funds received deposited in general fund and subject to appropriation control 2. Fees and charges prescribed by Legislature 3. Financial responsibility for higher education operations would be vested solely in state government	1. Operating fee collections deposited into state general fund 2. Tuition levels prescribed by Legislature 3. Services and activity fees, auxiliary enterprise revenues, etc. treated as "non-budgeted" funds 4. State government is primarily responsible for financing higher education operations	1. All funds raised by institution retained locally 2. Fees and charges established by institutional governing boards 3. Only state general funds subject to state appropriation 4. Financial responsibility is shared by state and institution	1. Institutions have total control over all funds 2. State appropriations made to third party state agency for purposes of contracting for services and enrollment opportunities 3. Ultimate financial responsibility vested in corporate institutions
Budgeting	1. The budget request would reflect a spending plan 2. Specific workload factors would serve as basis for level of institutional request 3. Relative efficiency would be a major criterion 4. Legislature would approve spending level for various programs, major activities, and objects of expenditure within programs and activities. Adherence would be expected.	1. Variety of formula and incremental bases may be employed 2. Detailed budget requests are prepared and submitted by institution, although major funding decisions are based on activity levels, base budgets, or other broad factors 3. Funding bases tend to be perceived as spending plans rather than funding vehicles	1. State support based on a general allocation formula--e.g., \$/FTE resident student 2. Appropriation is on a lump sum basis	1. Contract amounts determined through negotiation or external indices 2. Basic state-level budget decision would be number of spaces or levels of services to be "purchased"
Accountability	1. Accountability would focus on process considerations--adherence to spending plans, personal policies, etc.--and relatively little attention would be given to effectiveness of services provided	1. Major forces of oversight tends to be on process considerations with relatively little attention being given to effectiveness of services provided	1. Financial records must be auditable 2. Accountability reporting established as a parallel process and tends to focus more on effectiveness	1. Financial records must be auditable 2. Accountability provisions specified in contract that specifies meaning of "satisfactory performance"

Source: Adapted from Dennis Jones "Higher Education Budgeting at the State Level: A Perspective on Some of the Determinants" Mimeo. National Center for Higher Education Management Systems

resources. If they have to accept fewer resources, they want increased flexibility in use of the funds in exchange. In a number of states the kind of trade off that was negotiated in Colorado is under consideration.

Concepts of University Action

State budget procedures treat institutions as bureaucratic goal-directed organizations that make rational decisions about resource use, and with responsibility and accountability for their actions. This conception of university action assumes that "management efficiency" can be achieved by planning, by establishing clearer (and possibly more limited) goals and by analysing operations to make efficient resource allocations. Administrators are assumed to have enough power to make and implement decisions. This model of university organization fits the assumptions of PPBS and similar budget systems.

A very different conception of the university as an "organized anarchy" was developed by Cohen and March.⁵ They observed that the university had multiple and very general goals, uncertain means of achieving goals, and fluid participation. Universities are partly bureaucratic and hierarchial and partly a loose collegial structure. Power is widely dispersed and decisions are reached through political bargaining. A decentralized budget management "fits" this organizational structure best.

A third conception is of institutions as reactive organizations that are shaped primarily by external influences. The priorities of the funders determine the priorities of the institutions. Client preferences (students) and the funding objectives of granting agencies are major influences on institutional action. State appropriations that

have conditions attached to them will also shape institutional behavior. A "no strings" lump sum appropriation leaves the maximum discretion with the institution to determine its own directions. Budget systems that utilize incentives are consistent with this conception of university action. Strategic planning⁶ and management techniques are designed to develop a good "fit" between the organization's activities and the requirements of the environment.

A closely related conception is the "market model" which assumes that institutions are trying to maximize the quantity and/or quality of their clientele, and are competing with other providers for students and research support. The choices of clients determine the allocation resources, and budget systems should not interfere with the market as an efficient allocator of resources.

These descriptions of the way that higher education operates all have some basis in reality. Universities do goal directed planning, and sometimes act on the basis of their plans. All are influenced by the market and by other external forces. Power is dispersed, but universities also operate bureaucratically, and budget decisions are more centralized than academic decisions.

There are several dimensions involved in the descriptions above that are important for understanding the likelihood of success of budget reform. One is the degree of centralization or decentralization of budget decisions. A second is the extent of funding by clients (students, research grants) vs. funding by taxpayers. A third is the extent to which there is base support of the institution vs. categorical support of particular objectives. A fourth dimension is whether there is accountability for results, program accountability or procedural accountability.

Are there some budget reforms that will enable institutions to operate more effectively in the new environment than current budget systems? Anthony Morgan describes three possible "scenarios" about public planning and budgeting in the 1980's.

"The first is advancing technology coupled with the application of microeconomic theories to institutions of higher education. This scenario envisions a world of better data, sophisticated and refined analytic models, and management trained in the proper use of such models. A second scenario which might be labeled systematic thinking . . . the result emerging under this scenario is the implementation of fundamentally different ways of thinking and decision making. The third scenario envisions a fundamental shift in who makes resource allocation decisions. This [is the] virtues of the market scenario . . ."7

Morgan, like Wildvasky, Glenny and others is skeptical of the value and applicability of the "advancing technology" to higher education. Too few of the assumptions about clear goals, appropriate technology, adequate evaluation of results, and effective leadership are met by the average university. Morgan also rejects (for the public sector) the idea that the market will become a much more influential determinant of resource allocation. He gives a qualified endorsement to systematic thinking and effective leadership as the most promising direction.

The budget systems that would be most consistent with this approach to university action are not spelled out, but they would involve decentralizing decision making about the budget to the institutional level, and development of closer links between peer judgement, evaluation and budgets. A flexible response to changing environmental conditions and the other notions of strategic planning and management are also consistent with Morgan's "systematic thinking." Decentralized management is important to flexibility and responsiveness, and this conception of the basis for university action would be consistent with a state budget system that leaves major resource allocation decisions at

the campus level.

The current literature on retrenchment and reallocation of resources⁸ contains similar themes. The importance of getting institutions to do effective self evaluation, assess the future student market and the resources that will be available, and to set priorities and allocate resources on the basis of priorities rather than simply maintaining existing interest groups in the budget process are all themes of the retrenchment literature.

The implications for budgeting in the retrenchment literature are several. First, give institutions more flexibility and autonomy in the management of resources. Second, provide incentives to institutions for good management and/or resource reallocation. Third, make budget processes more market sensitive.

The model of the "effective institution" which emerges from the literature is one which is flexible, decentralized and responsive to its markets. It has a clear role and mission, is capable of concerted action, engages in planning, and is accountable for results. It engages in self evaluation and uses the results to set priorities. The budget will be managed at the program level and will contain incentives for good management.

The effective institution has a lot of autonomy in managing its own resources, but it must also be responsive to state priorities which may be different from the priorities that the institution would develop itself. The budget is the "exchange" the state can use to obtain services and programs that it wants from the institutions.

The dilemma of the state interested in qualitative improvement of higher education is whether it can depend on the colleges and

universities to give a high enough priority to the improvements the state wants, or whether it needs to provide budget incentives, or budget directives, to get action from the institution. If the state modifies its budget process to give institutions more flexibility and autonomy in managing their own affairs, how can it get institutions to deal with state priority issues?

One answer is categorical support and budget incentives. The state can provide specific funds for high priority concerns such as improving teacher education, or upgrading engineering and computer sciences. These special funds can require institutional matching by reallocation of funds from low priority institutional activities. The budget in this example contains both a program incentive and an incentive to set priorities and reallocate funds. The special funding may also require the evaluation of the special program to see if it is achieving its objectives at the end of a three to five year period. Accountability for results can be built into these categorical programs on the front end by specifying outcomes that are to be achieved. The categorical program becomes the equivalent of a contract between the state and the institution, the state furnishes the money, and the institution is committed to achieving certain specified outcomes.

State budget reform in the 1980's may be more successful than the PPBS and zero based reforms of the 1970's because it recognizes the organizational and incentive structure that exists in higher education. By moving the state-institutional budget relationship toward the state assisted, and away from the state controlled model, institutional flexibility is being increased.

Budget Systems to Make Higher Education More Dynamic

The next decade is one where institutional growth, improvement or

renewal will be especially difficult because of demographic and economic conditions. Public budget processes tend to be very conservative. Continuation funding takes precedence over new funding in most budget systems, and the politics of budget development favor the interests of existing stakeholders and power blocks over those of newcomers who are seeking to be included in the budget. The decision process in colleges and universities about programs tends to be conservative. Faculty interest groups usually determine which new program proposals will be advanced, and the politics of institutional budget making make it difficult to get funds for new programs, or to reallocate resources except in periods of crisis and threat to the survival of the institutions.

States can encourage institutional change and renewal by providing incentives to institutions to manage their resources more effectively, and by giving them matching funds to develop new and improved programs. The characteristics of state budget systems that will encourage, rather than impede change and improvement include:

- (1) The budget system should maximize institutional responsibility for managing the budget. Detailed state spending and personnel controls should be eliminated. The budget rules should encourage thrift and allow flexibility in managing available resources.

- (2) Detailed procedural accountability should be replaced by accountability for results. Institutions should be required to have an evaluation process that emphasizes outcomes, and that can be used by institutional leaders and officials in making subsequent resource allocation decisions.

- (3) The budget process should keep decisions about resources as

close to the point where services are delivered and operations are managed as possible. Budget structure should recognize that universities should not be run in a bureaucratic hierarchical way.

(4) The budget process should not protect the institution against the operation of student choice, but should give the institution time to implement adjustments that are necessary because of market shifts. Appropriate budget adjustments should approximate the marginal costs of gaining or losing students.

(5) The budget process should provide some resources at the institutional level for development and new initiatives, rather than allocating all funds to specific ongoing programs.

(6) The budget process at the state level should provide some incentives to institutions for institutional improvement and new developments. Among the kinds of fiscal incentives the state can use are:

a) Matching state funds for private funds raised by the institution. These developmental funds could be used to attract distinguished faculty, provide scholarships for outstanding students, retrain faculty to offer a new course or develop a new program, provide funds for a new research program or other improvement objectives of the institution.

b) Matching state funds for a new institutional project similar to those described in a) above, with the institution's matching funds coming from reallocation of "saving" of funds in other parts of the budget.

c) Funds for beginning, expanding or improving programs that are a high state priority. These may include programs that are both institutional and state priorities; such as the development of

"centers of excellence" in particular subjects or fields that are important to the state.

d) State funds for a competitive "instructional excellence" program. Institutions would submit proposals for improvement activities that could be evaluated by experts selected by the state. Criteria for submitting and evaluating proposals could be developed by institutional and state officials before the program was initiated.

e) State funds for contracting for specific improvement activities (instruction, research or service or some combination of them) with specific institutions with anticipated results and accountability specified in the contract.

By following the six points listed above, states could provide a budget process that encouraged change, renewal, and achievement of both state improvement objectives and institutional goals for improvement. These budget changes are not inconsistent with the political and organizational characteristics of higher education institutions, and should be achievable through evolution of budget rules, rather than providing a radical new budget structure. The suggestions emphasize incentives and the importance of an evaluation system to guide state resource allocation decisions, but does not require the development of evaluation systems that are so complex that they cannot be successfully implemented.

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